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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 257

GORDON P. HAYNES AND ESSIE M. HAYNES, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the Court of Appeals (R. 103–124) is reported at 233 F. 2d 413. The findings of fact and conclusions of law of the District Court (R. 48–52) are reported at 139 F. Supp. 671.

JURISDICTION

The judgment of the Court of Appeals was entered on April 20, 1956. (R. 125.) The petition for a writ of certiorari was filed on July 16, 1956, and was granted on October 8, 1956. (R. 126.) The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

The taxpayer was absent from work during 1949 because of illness. For the period of such absence, his regular salary, in the amount of $2,100, was paid to him by his employer pursuant to a company plan providing for such payments.

The question presented is whether this $2,100 was taxable as compensation for services rendered under Section 22 (a) of the Internal Revenue Code of 1939, or was exempt from tax as an amount "received, through * * * health insurance" within the meaning of Section 22 (b) (5) of the Code.

STATUTES INVOLVED

The pertinent provisions of Section 22 (a) and (b) (5) of the Internal Revenue Code of 1939 and of Sections 104, 105, and 106 of the Internal Revenue Code of 1954 are set forth in the Appendix, *infra*, pp. 40–44.

STATEMENT

This case involves a claim for refund of federal income taxes collected for the year 1949. The relevant findings of fact made by the District Court (R. 48–51) and the undisputed evidence may be summarized as follows:

During the year 1949, the taxpayer, Gordon P. Haynes, was employed by the Southern Bell Telephone and Telegraph Company. During that year, Haynes became sick and was paid $2,100 in "Sickness Disability Benefits" (R. 72) under a plan of the company called a "Plan for Employees' Pension,

Disability Benefits and Death Benefits" (Pltf. Ex. 1, R. 5, 49, 62–88). The $2,100 paid Haynes under the plan was the same amount which would have been paid him had he worked and received his regular salary. The company withheld $318.44, for income taxes, from the $2,100 paid Haynes, and the former sum was paid by the company to the Collector of Internal Revenue. (R. 49.)

The "Plan for Employees' Pension, Disability Benefits and Death Benefits," inaugurated by the company in 1913, is set forth in terms of company regulations. (R. 49, 62.) It provides for service pensions and for a pension fund (R. 62–69), for "Accident Disability Benefits" (R. 69–71), "Sickness Disability Benefits" (R. 72–73) and "Death Benefits" (R. 73–79). The "Sickness Disability Benefits" are paid to all employees who have more than two years service. The benefits paid to employees differ in amount and duration, varying with the length of service of the employee. For example, employees whose terms of employment have been from two to five years are entitled to full pay for four weeks and one-half pay for nine weeks; employees whose terms of employment have been twenty-five years or more are entitled to full pay for fifty-two weeks. (R. 49, 72). Haynes had been employed by the company over twenty-five years and he was entitled to receive his full salary for fifty-two weeks. (R. 49.)

"Sickness Disability Benefits" are paid under the plan beginning on the eighth calendar day of absence due to illness, unless the employee has received benefits

for a prior period and is again absent on account of sickness within two weeks of the termination of such period. (R. 50, 72–73.) The employees, under some circumstances, continue to receive their full salary during the first week of absence and the company does not distinguish between amounts paid for the first week and amounts paid under the plan. (R. 25, 50.) Benefits are not paid during a period of lay-off and no employee has a right to benefits after his discharge. (R. 49.) Benefits are not paid for any period during which the employee is receiving wages from the company. (R. 73.)

Employees are not required to take a physical examination or make application in order to qualify for benefits under the plan. No contribution of cash is made by the employees in order to qualify. The plan is administered by a general committee of five members who are appointed and serve during the pleasure of the board of directors of the company. The members of the committee are appointed from the operating heads of departments of the company and not over three hours per week is devoted by them to committee work. They are responsible to the board of directors and the president of the company. (R. 50.) The committee's determination of questions arising under the plan is conclusive. (R. 63.) In the event of the absence of an employee for sickness, the secretary of the committee authorizes payment of benefits to the employee, subject to the ratification of the committee. The committee is also empowered to authorize payments in excess of those provided by the

plan and to make loans to employees. In cases of need, the committee has made payments in excess of those provided in the plan. The company has never been sued for "sickness disability benefits." (R. 50.)

The company does not maintain a fund from which "sickness disability benefits" are paid; all such payments are charged to operating expenses. The benefits are not administered by a trust or association and the company has not established a reserve on its books against which to charge such benefits. No insurance reserve has been set up and, unlike payments to the pension fund under the plan, the cost of "sickness disability benefits" is not determined by contributions on an actuarial basis. (R. 50–51.)

Payment to an employee for time actually worked and for "sickness disability benefits" accruing in the same pay period is generally made in one check; where an employee works part of one day and is entitled to "sickness disability benefits" for the remainder of the day, the entire amount paid to him for that day is charged to his regular salary account. Approximately two per cent of the company's pay roll in 1949 represented "sickness disability benefits"; a total of $1,700,000 was paid in such benefits during that year. (R. 51.)

The Southern Bell Telephone and Telegraph Company is not licensed by the State of Georgia to engage in the business of health insurance. Insurance companies which engage in the business of writing health insurance do not usually pay benefits of more than eighty per cent of the insured's salary; in group health

insurance, the limitation is approximately two-thirds of the salary earned. The purpose of such limitations is to provide incentive for the insured to return to work as quickly as possible. It is not the practice of insurance companies to issue policies where the period during which benefits will be paid is dependent upon the length of time the insured has been employed in a particular position. (R. 51.)

The District Court concluded, following *Epmeier* v. *United States*, 199 F. 2d 508 (C. A. 7th), that the $2,100 received by Haynes during the year 1949 was received through health insurance within the meaning of Section 22 (b) (5) of the Internal Revenue Code of 1939, and that it was not includible in gross income. (R. 51–52.) The United States appealed from the judgment of the District Court (R. 54) and the Court of Appeals for the Fifth Circuit reversed. (R. 125.)

SUMMARY OF ARGUMENT

1. The amounts received by taxpayer from his employer in continuation of his regular salary during periods in which he was sick are not exempt from tax under Section 22 (b) (5) of the Internal Revenue Code of 1939 as "amounts received, through * * * health insurance * * * as compensation for personal injuries or sickness," but, instead, represent compensation for services rendered or to be rendered and are taxable as such under the broad reach of Code Section 22 (a). In common understanding, such wage continuations by employers are not regarded as insurance payments or as compensation for sickness. There is nothing in the legislative history or background of Section 22 (b) (5)

which suggests that, in creating this narrow exemption, Congress intended that payments by an employer to an employee during a period of sick leave were to be classified as exempt proceeds of "insurance" rather than as compensation for personal services.

The background of the statutory exemption establishes, on the contrary, that Congress was dealing with amounts received through conventional modes of insurance—proceeds from insurance policies. Moreover, congressional amendments to the 1939 Code providing for exclusion of amounts received as pensions for sickness or injury resulting from service in the armed forces and for the exclusion of military pay during periods of hospitalization would have been unnecessary if employer payments to employees during periods of illness were already exempt as payments through "health insurance." Nor is there any indication that Congress ever envisaged that the Federal Government would be regarded as an insurer in granting sick leave pay to its own employees or that federal employees would be entitled to claim an exemption for that part of their salary attributable to periods of absence on sick leave.

A further indication that Congress recognized that payments by an employer which are prompted by the employment relationship are compensation for personal services and are not "insurance" proceeds is found in Section 22 (b) (1) of the 1939 Code. That section, which exempts amounts received under life insurance contracts, was amended by Congress in 1951 to provide an additional, but limited, exemption

for amounts received under a "contract of an employer" providing for the payment of a fixed amount on the death of an employee. This amendment was deemed necessary by Congress since such payments were not viewed as amounts received through insurance and were otherwise taxable in full. An employer's continuation of wages during illness is no more like insurance proceeds than is a death benefit paid by an employer. Neither is exempt from tax except as Congress makes explicit provisions. Admittedly, no special exemption for wage continuations during illness existed during the taxable year here in issue. Such an exemption (again, limited) was first created in the Internal Revenue Code of 1954.

2. In the Internal Revenue Code of 1954, Congress enacted a comprehensive tax plan dealing with benefits received by an employee from his employer during periods of absence from work because of sickness. Recognizing that such benefits, when received from an employer, are in fact compensation for services and taxable as such, Congress carefully exempted only a limited amount ($100 per week) of such benefits from tax, whether they were directly paid by the employer or were attributable to employer contributions toward conventional health insurance policies for employees. In urging that sick leave benefits were entirely exempt under the 1939 Code, the taxpayer is seeking a broader exemption than Congress thought desirable when it enacted the 1954 Code. Yet, there is no evidence that, in adopting the 1954 Code, Congress was acting to restrict

the tax benefits already available under the 1939 Code to one in taxpayer's position. On the contrary, the entire tenor of the legislative history is that Congress proposed to enlarge the tax benefits available to employees when it legislated so as to exempt a part, but not all, of sick leave pay; and since Congress plainly recognized the compensatory nature of such payments, the 1954 Code furnishes convincing evidence that sick leave payments by employers were not exempt under the 1939 Code as "amounts received, through * * * health insurance."

3. The plan of taxpayer's employer for the payment of sick leave benefits does not have any of the essential characteristics of health insurance. There are no definable premium payments by the employee; there is no separate fund established out of which benefits are paid; there is no actuarial computation of risks involved or assumption of those risks. Yet, all of these are common characteristics and indicia of "insurance." Instead, employees with identical risks are treated differently under the plan, the benefits payable being related, not to risk alone, but to length of employment with the company. As a consequence, the plan tends to encourage and reward long periods of service and is clearly compensation for services. Benefits are not paid during a period of lay-off or for a period in which the employee receives wages from the company. Although employees, in some circumstances, continue to receive their regular salary during the first seven days of illness (a benefit not provided by the plan), these

payments, which are immediately recognizable as taxable sick leave payments, are indistinguishable from those made under the plan, and are not treated any differently by the company from payments under the plan.

Everything points to the conclusion that the amounts involved in this case were paid by taxpayer's employer and received by taxpayer as part of his compensation for personal services rendered or to be rendered. To treat such an important element of compensation as an amount received through "health insurance" requires that this statutory exemption from tax be given a strained construction—one which has no basis in the legislative history and which departs from the ordinary meaning of the words.

ARGUMENT

SICK LEAVE PAYMENTS RECEIVED BY AN EMPLOYEE FROM HIS EMPLOYER REPRESENT A "FRINGE BENEFIT" TAXABLE AS COMPENSATION FOR SERVICES. SUCH PAYMENTS ARE NOT EXEMPT AS AMOUNTS RECEIVED THROUGH HEALTH INSURANCE UNDER SECTION 22 (B) (5) OF THE INTERNAL REVENUE CODE OF 1939

A. PRELIMINARY

At various times during the year 1949, taxpayer, Gordon P. Haynes, was absent from work because of illness. During these periods of absence, he continued to receive amounts equivalent to his normal salary pursuant to a plan of his employer, the Southern Bell Telephone and Telegraph Company. The total

amount which he received during the periods in which he was absent from work in 1949 was $2,100. (R. 49.) Unless Congress has specifically provided for its exclusion from gross income, this amount is clearly taxable as income under Section 22 (a) of the Internal Revenue Code of 1939. Cf. *Commissioner* v. *Lo Bue*, 351 U. S. 243, 247. The question is whether the $2,100 is, in its entirety, excludable from the employee's taxable income as an amount received "through accident or health insurance * * * as compensation for personal injuries or sickness" under Section 22 (b) (5) of the 1939 Code (Appendix, *infra*, pp. 5–6).[1]

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[1] Whether sickness benefits plans of employers for their employees qualify as health insurance within the intent of Congress in Section 22 (b) (5) of the Code is a question which has been before two other Courts of Appeals. In *Epmeier* v. *United States*, 199 F. 2d 508 (C. A. 7th), a plan of the Lincoln National Life Insurance Company was involved. And in *Moholy* v. *United States* 235 F. 2d 562 (C. A. 9th), the plan of the San Francisco Fire Commission was at issue. The *Epmeier* case held, we believe incorrectly, that the plan did constitute health insurance. The Ninth Circuit, in the *Moholy* case, reached the opposite result. The Tax Court also has had occasion to consider this problem in a case involving the sickness benefits plan of the Esso Standard Oil Company. It held that the plan was a sick leave plan which did not qualify as health insurance and that payments made pursuant to the plan were taxable as compensation. *Oliva* v. *Commissioner*, 25 T. C. 1289. See also *McQueen* v. *Commissioner*, decided June 19, 1956 (1956 P–H T. C. Memorandum Decisions, par. 56,143).

In addition, numerous District Courts have considered the problem, reaching divergent results.

Decided for the Government on this issue are: *Adams* v. *United States* (N. D. Tex.), decided April 27, 1956 (not reported); *Branham* v. *United States*, 136 F. Supp. 342 (W. D. Ky.); *Cary*

The case thus presents the narrow problem of ascertaining what Congress meant by the words "health insurance." Did Congress regard payments made by an employer to an employee during periods of absence because of illness as being "insurance" payments which should be *exempt* from income taxation? Or did Congress, in creating an exemption for "health insurance" (as it has for other types of insurance payments received), limit this exception to payments received under normal, conventional modes of insurance, as distinguished from sick leave payments by an employer to an employee (which are usually and quite aptly described as "compensation" for personal services, which is taxable under Section 22 (a) of the 1939 Code, Appendix, *infra*, p. 40)?

We shall argue that the specific indicia of congressional meaning point to the conclusion that Congress did not propose that wage continuations during illness should be classified as "health insurance", but, rather, that such payments, like all other direct economic benefits which flow to an employee as a con-

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v. *United States*, 141 F. Supp. 750 (Nebr.); *Gumble* v. *United States* (S. D. Tex.), decided June 4, 1956 (1956 C. C. H., par. 9666); *Hanna* v. *United States* (N. D. Tex.), decided May 25, 1956 (1956 C. C. H., par. 9736); *Townsend* v. *United States*, 143 F. Supp. 150 (S. D. Ill.).

Cases decided for the taxpayer on this issue are: *Adams* v. *Pitts*, 140 F. Supp. 618 (E. D. S. C.); *Herbkersman* v. *United States*, 133 F. Supp. 495 (S. D. Ohio); *Pfleiderer* v. *United States* (S. D. Ind.), decided July 20, 1956 (1956 C. C. H., par. 9869); *Priebe* v. *United States* (Ariz.), decided April 9, 1956 (1956 C. C. H., par. 9478); *Stanley* v. *United States* (S. D. Ind.), decided July 20, 1956 (1956 C. C. H., par. 9870); *Tinsley* v. *United States* (W. D. Okla.), decided March 27, 1956 (1956 C. C. H., par. 9604).

sequence of the employment relationship, including certain i. e., so-called "fringe benefits", should be taxed as compensation when received." Indeed, as will be seen (pp. 22–28, *infra*), when Congress later intended to give a special, but limited, tax treatment to such wage continuation plans, it dealt with them specifically.

We shall also point out that a sick leave plan is in essence a continuation of wages or compensation. Under such a plan, the employee's compensation is continued, in whole or in substantial part, while he is absent from work, through no fault of his own, because of illness. The employee, as it were, is excused since the employer does not insist that he continue to work while ill as a condition to receiving pay. But what the employee receives is just as much in the nature of compensation as his regular pay. The most familiar example of such an arrangement is the Federal Government's long-standing sick leave plan, under which salary payments to employees continue while they are on such leave.

Before turning to the history of the exemption provision in question, we would emphasize that the decisions uniformly recognize that the definition of taxable income in Section 22 (a), viewed in the light of the evident policy of Congress, is to be given broad application (*Commissioner* v. *LoBue* 351 U. S. 243, 247; *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426, 429–430; *Commissioner* v. *Jacobson*, 336 U. S. 28, 49; *Robertson* v. *United States*, 343 U. S. 711); conversely, when the claim is that income has been

exempted from tax, the exemption must be "construed with restraint in the light of the same policy" (*Commissioner* v. *Jacobson, supra*, p. 49). With particular reference to compensation for personal services, the decisions have recognized that "income" comprehends any direct economic benefit, whatever its form, which moves from an employer to an employee as a consequence of the employment relationship, whether it be designed to compensate for past, present or future services or even to enlist more efficient services. *Commissioner* v. *LoBue, supra; Robertson* v. *United States, supra; Commissioner* v. *Smith*, 324 U. S. 177, 181, rehearing denied, 324 U. S. 695; *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716, 729.

B. THE RELEVANT GUIDES TO THE CONGRESSIONAL PURPOSE SHOW THAT AMOUNTS PAID UNDER SICK LEAVE PLANS ESTABLISHED BY AN EMPLOYER FOR HIS EMPLOYEES ARE NOT TO BE CONSIDERED "AMOUNTS RECEIVED, THROUGH * * * HEALTH INSURANCE" WITHIN THE MEANING OF SECTION 22 (B) (5) OF THE INTERNAL REVENUE CODE OF 1939

Section 22 (b) (5) first became a part of the tax law as Section 213 (b) (6) of the Revenue Act of 1918, c. 18, 40 Stat. 1057. Although the legislative history of that section is not extensive, it does reveal that Congress was attempting to provide a solution to a specific type of question. And when that problem, together with its congressional solution, is considered in connection with the sick leave plan here involved, it becomes evident, we submit, that it was not within the congressional purpose to create an exemption from tax for what is essentially remuneration being paid by an employer to an employee.

The report of the House Ways and Means Committee, in discussing what was to become Section 213 (b) (6) of the Revenue Act of 1918, is as follows (H. Rep. No. 767, 65th Cong., 2d sess., pp. 9–10 (1939-1 Cum. Bull. (Part 2) 86, 92)):

> Under the present law it is doubtful whether amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injury or sickness, and damages received on account of such injuries or sickness, are required to be included in gross income. The proposed bill provides that such amounts shall not be included in gross income.

The doubts which created the problem that Congress attempted to resolve arose in deciding what items were to be treated as "income" under the Revenue Acts. On the administrative level, the taxability of proceeds of accident insurance policies had been the subject of differences of opinion. A Treasury Decision had been promulgated holding that such insurance proceeds were taxable income. T. D. 2135, 17 Treasury Decisions 39 (1915). Thereafter, however, the Secretary of the Treasury requested the opinion of the Attorney General as to whether "the proceeds of an accident insurance policy received by an individual on account of personal injuries sustained by him through accident are income taxable" under the Revenue Acts of 1916 and 1917. The Attorney General concluded (31 Op. A. G. 304 (1918)) that such proceeds were not taxable income. This opinion was based upon an interpretation of the

then recent decisions[2] of this Court holding that returns of capital were not income. The Attorney General was of the view that the proceeds of an accident insurance policy were a substitute for "capital which is the source of future periodical income," merely taking "the place of capital in human ability which was destroyed by the accident". (31 Op. A. G. 304, 308 (1918).) In accordance with this theory, the Treasury then ruled[3] that proceeds of accident insurance policies were not taxable income and revoked parts of its earlier decision to the contrary.

It is against this background—one of recurrent doubt on the part of officials of the executive establishment as to the taxability of accident policy proceeds—that the Congress decided to exempt "amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injuries or sickness." The plain inference is that Congress proposed to exempt only "proceeds" received under conventional modes of insurance.[4]

Nothing in the background or history of the exemption provision remotely suggests that a continuation of wages or salary during a period of

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[2] *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179; *Lynch* v. *Turrish*, 247 U. S. 221; and *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330.

[3] T. D. 2747, issued July 12, 1918, 20 Treasury Decisions 457 (1918).

[4] The Seventh Circuit, in the *Epmeier* case, was of the opinion that Section 22 (b) (5) was enacted with the intention of giving relief to taxpayers who have the misfortune to become ill. See 199 F. 2d 508, 511. The legislative history and background of the section offer no support for this theory.

illness was to be treated for tax purposes differently from other types of compensation. The opinion of the Attorney General and the Treasury Decisions did not deal with payments to employees by an employer. They considered only the usual kind of "*proceeds*" from an "accident insurance *policy*". [Emphasis added.] (31 Op. A. G. 304 (1918).)[5] See also T. D. 2747, *supra*.

As a matter of everyday speech and usage, the plan involved in the instant case is not thought of as "health insurance"; it would be called a "sick leave" plan. There is no reason to suppose that, in using the expression "health insurance", Congress meant anything other than conventional insurance.[6] The presumption that Congress was using "health insurance" in its usual sense is, of course, buttressed by the references in the background of the statute to *proceeds* from an *insurance policy* and by the fact that Congress intended to exempt from tax only those kinds of receipts that, in the then current stage of development of tax law, were thought to be analogous to returns of capital. Indeed, if the purpose of Congress had been to exempt from tax any amount received by an employee during

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[5] In the event that an employer paid all or a part of the premiums on an individual accident or health insurance policy for an employee, the payments by the employer would, in the absence of a specific exclusion, be includible in the employee's gross income. Cf. Rev. Rul. 210, 1953-2 Cum. Bull. 114.

[6] The normal rule that, absent special indications to the contrary, words in a statute are to be given their everyday meaning (*Crane* v. *Commissioner*, 331 U. S. 1, 6) applies with particular force here since the taxpayers are urging that this Court adopt an expansive interpretation of an exemption section.

a period of illness, the statute would doubtless have been drafted differently.[7] Apart from the fact that an employer's continuation of wages during illness is compensation for past and future services and is not "compensation for personal injuries or sickness", the qualifying phrase "through accident or health insurance or under workmen's compensation acts" must be given effect. We submit that any meaning which can be fairly assigned to this phrase is not broad enough to encompass a plan of an employer whereby his employee, in consideration for both his past and future services, can expect to receive his regular compensation, in whole or in part, during a certain period of illness.

Further support for the position that Congress did not view the "health insurance" exemption as broadly as taxpayer is evidenced by an amendment made in 1942. From 1918 until 1942, Code Section 22 (b) (5) and its predecessors had remained unchanged. By Section 113 of the Revenue Act of 1942, c. 619, 56 Stat. 798, language was added so as to include in the exemption "*amounts received* as a pension, annuity, or similar allowance *for* personal injuries or *sickness* resulting

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[7] Section 1426 (a) (2) of the Internal Revenue Code of 1939, as amended by Section 203 (a) of the Social Security Act Amendments of 1950, c. 809, 64 Stat. 477, demonstrates that when Congress intends to describe this kind of payment it knows how to do so specifically. This section also indicates that Congress considered these amounts "wages" and thought that a specific exception was necessary to prevent them from being included in the definition of that word. Cf. Section 1607 (b), Internal Revenue Code of 1939, as amended by Section 209 (a) of the Social Security Act Amendments of 1950.

from active service in the armed forces of any country."[8] (Emphasis added.) If taxpayer's approach to the statute and the expansive concept of "insurance" which he urges are correct, there would have been no need for this amendment and the limited exemption which it added. That is, if the taxpayer is right in contending that a plan whereby an employer undertakes to pay all or a part of an employee's remuneration during periods of disability for illness is "health insurance" within the contemplation of the statute, it would similarly be true that the payments described by the 1942 amendment are received through health insurance. But Congress, quite obviously, in making the amendment did not regard the statute as being so broad.[9]

In this connection, it should be added that the Federal Government had (as it still does) a sick leave plan for its employees, providing for a continuation of salary in the event of illness. See Act of March 3, 1893, c. 211, 27 Stat. 675, 715, Sec. 5, as amended by the Act of March 15, 1898, c. 68, 30 Stat. 277, 316, Sec. 7; Act of July 7, 1898, c. 571, 30 Stat. 652, 653, Sec. 1; and Act of February 24, 1899, c. 187, 30 Stat. 846, 890, Sec. 4. Undoubtedly, Congress was aware of the existence of these benefits being paid to Government employees when the predecessor of

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[8] Section 127 (d) of the 1942 Act also amended Code Section 22 (b) (5) in another respect which is discussed *infra*, pp. 34–35.

[9] See also 1939 Code Section 22 (b) (13) (A) (ii) and (B) (ii), as amended by Section 305 (a) of the Revenue Act of 1951, c. 521, 65 Stat. 452, dealing with a special exclusion for military pay during a period of hospitalization.

Section 22 (b) (5) found its way into the law. Yet, there is no basis for believing that Congress viewed the Federal Government as giving "health insurance" to its employees and as acting in the capacity of an insurer. The taxpayer's arguments [10] would lead to the conclusion that Congress intended to exempt a federal employee's salary for every hour, day or week of absence on sick leave—a conclusion most difficult to accept, particularly in view of the limited exemption for military personnel created by the 1942 amendment.

There is still another indication that Congress drew a distinction between conventional modes of insurance and payments made by an employer. In Section 22 (b) (1) of the 1939 Code (26 U. S. C. 1952 ed., Sec. 22), as in predecessor statutes, Congress provided that "Amounts received under a life insurance contract paid by reason of the death of the insured" should not be included in gross income. By Section 302 of the Revenue Act of 1951, c. 521, 65 Stat. 452, Congress amended this section to read as follows:

> (1) *Life insurance, etc.*—Amounts received—

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[10] The *amicus curiae* brief (p. 24) attempts to distinguish *Moholy* v. *United States*, *supra*, on the ground that it involved the sick leave plan of the San Francisco Fire Commission. There is no basis for such a distinction. The rights of an employee under such a plan are not less because the employee is a civil servant and his rights are provided for by statute or municipal regulations rather than a pamphlet of the type issued by the telephone company in this case. Cf. *Sleigh* v. *United States*, 9 C. Cls. 369.

(A) under a life insurance contract, paid by reason of the death of the insured; or

(B) *under a contract of an employer providing for the payment of such amounts to the beneficiaries of an employee, paid by reason of the death of the employee;*

* * * The Aggregate of the amounts excludible under subparagraph (B) by all the beneficiaries of the employee under all such contracts of any one employer may not exceed $5,000. [Emphasis added.]

This amendment was explained by the Committee on Finance of the Senate in the following manner (S. Rep. No. 781, 82d Cong., 1st sess., p. 50 (1951–2 Cum. Bull. 458, 492):

> Section 22 (b) (1) of the code excludes from gross income amounts received under a life-insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise. *However, by its terms, this provision is limited to life-insurance payments, and the exclusion does not extend to death benefits paid by an employer by reason of the death of an employee.* [Emphasis added.]

Section 22 (b) (5) excludes amounts received through accident or health insurance. Section 22 (b) (1) excludes amounts received under a life insurance contract. And when Congress desired that death benefits paid by an employer to a deceased employee's beneficiary should be exempt, it considered that "by its terms" Section 22 (b) (1) was "limited to life insurance payments," and that the exclusion did "not extend to death benefits paid by an employer by

reason of the death of an employee." S. Rep. No. 781, *supra*. Certainly, if a plan such as the one in the instant case, which also provides for death benefits (R. 73–79), was thought by Congress not to be a "life insurance contract" within the meaning of Section 22 (b) (1), and Congress, therefore, deemed it necessary to amend the statute to provide for a limited exclusion of benefits paid under such a plan, Congress similarly must have considered that such a plan, in providing for sick leave benefits, was not a "health insurance" contract within the purview of Section 22 (b) (5). And the absence of any amendment to provide for the exclusion of such sick leave benefits, at a time when Congress recognized that companion death benefits were not excluded by Section 22 (b) (1) and changed the law in that respect,[11] furnishes convincing evidence that Congress did not intend that sick leave benefits should be exempt from tax.

C. THE COMPREHENSIVE CHANGES ADOPTED BY CONGRESS IN THE INTERNAL REVENUE CODE OF 1954 SUPPORT THE CONCLUSION THAT AN EMPLOYER'S SICK LEAVE PLAN WAS NOT HEALTH INSURANCE UNDER SECTION 22 (B) (5) OF THE 1939 CODE

In enacting the Internal Revenue Code of 1954, Congress adopted (Sections 104 through 106, Appendix, *infra*, pp. 41–44) a comprehensive tax policy for

[11] The limitation placed on the exclusion of death benefits paid by an employer is a further indication that Congress has recognized the nature of such a "fringe benefit" to be compensation and normally taxable as such, and that it has proceeded slowly in this area by exempting from tax only a portion of the otherwise taxable compensation.

dealing not only with health and other similar insurance payments, but also with various types of payments made by an employer to an employee. Since these changes reflect congressional understanding of the provisions of the 1939 Code, they provide an aid to interpretation.

1. Congress recognized that Section 22 (b) (5) of the 1939 Code was limited to amounts paid "under a contract of insurance" and that employees who received sick benefits were subject to "substantially different tax treatment" depending on the technical nature of the plan under which the benefits were made available. H. Rep. No. 1337, 83d Cong., 2d sess., p. 15 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4039). Referring, with seeming disapproval, to the decision in *Epmeier* v. *United States*, 199 F. 2d 508 (C. A. 7th) and its holding that "health insurance" was there involved even though there was "no formal insurance policy but merely an employer's plan for payment of sickness benefits" (H. Rep. No. 1337, *supra*, p. A33), the House Committee on Ways and Means proposed to enact a "uniform rule" for payments "received by an employee" without regard to whether "such amounts are funded through insurance" (H. Rep. No. 1337, *supra*, p. A33 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4169)). See also S. Rep. No. 1622, 83d Cong., 2d sess., pp. 15, 183–186 (3 U. S. C. Cong. & Adm. News (1954) 4621, 4645, 4817–4820).

If Congress had viewed Section 22 (b) (5) of the 1939 Code as already embracing all employers' plans for wage continuations during illness, regard-

less of whether accomplished through conventional modes of insurance, there would have been no lack of uniformity under existing law which called for legislative correction.[12]

2. That Congress did not view a mere plan to continue wage payments during illness as already embraced by the *total* exclusion granted under the 1939 Code to "health insurance", is evident, too, from the fact that, in extending the exclusion to employers' wage continuation plans, Congress *limited* the amount which would be non-taxable where an employment relationship exists. That is, where payments are received by an employee "in lieu of wages" during absence from work on account of sickness or injuries, an amount *not in excess of $100 per week* is excludable from taxable income and any amount in excess of that continues to be taxable. Furthermore, there is no exclusion for payments during the first week of illness, unless the employee has been hospitalized for at least one day during that period. 1954 Code Section 105 (a), (d) and (e). In contrast, where the payments are received under a conventional mode of accident or health insurance by a taxpayer and the insurance is not attributable to

[12] It is also of some significance that, in providing for a uniform scheme of taxation, Congress found it necessary to state expressly in Section 105 (e) of the 1954 Code that "for purposes" of Sections 104 and 105, amounts received under a "health plan" for employees "shall be treated" as amounts received through "health insurance"—a plain indication that the normal usage of the term "health insurance" would not, except for express statutory direction, include such plans.

an employment relationship, the *entire* proceeds are exempt from tax, as they were under the 1939 Code. 1954 Code Section 104 (a) (3). Congress has thus recognized that compensation for personal services is necessarily involved where an employment relationship exists and has drawn a distinction between wage continuations received by employees during illness and sick benefits received by others. The former were granted a limited exemption, while the latter (who would normally receive payments only because of an insurance arrangement) continue to have a total exemption.[13]

If it be true, as taxpayer contends, that payments under all employer plans were already exempt in full under the 1939 Code, Congress, by limiting the exempt amount to $100 per week and by allowing no exemption for the first week's payments, sharply restricted the benefits available under existing law. But there is not the slightest suggestion in the legislative history that Congress was taking away tax benefits from those receiving monies under wage continuation plans. On the contrary, the entire tenor of the legislative history is that, where such employer payments are involved,

[13] Where an employment relationship exists *and* policies of insurance are taken out, Congress has provided as follows: To the extent that part of the premium is paid by the employee, a proportionate part of the insurance payments is entirely exempt from tax. To the extent, however, that part of the cost is paid by the employer, the remaining, proportionate part which is received by the employee during illness is not entirely exempt, but is subject to the limitations described above. This is an obvious recognition that what the employee receives as a consequence of the employer's contribution is essentially compensatory in nature.

Congress was enlarging (to a limited degree) the tax benefits of an employee, just as it had previously done in connection with death benefits paid by an employer. See pp. 20–22, *supra*. In sum, Congress was unwilling to do what the taxpayer, in effect, is urging this Court to do, namely, grant a total exclusion for such wage continuations during illness.[14]

3. The 1954 Code provisions also illustrate that the taxpayer's attempt to equate a wage continuation plan with conventional concepts of insurance is erroneous in another respect. Taxpayer contends that an employee, by rendering services, is furnishing consideration (Br. 14–15). This presumably means that the employee receives less in the form of cash wage payments when on the job than he would be entitled to receive if the employer made no provision for wage continuations during illness. And it is urged that this theoretical wage differential is, in substance, a premium paid for the "insurance" afforded by the

[14] The 1954 Code does narrow pre-existing law in the situation where the employer pays premiums on health insurance for his employees. Payments under such contracts of insurance were entirely exempt to the employee under Section 22 (b) (5) of the 1939 Code, while the limitations of 1954 Code Section 105 (d) apply to the proceeds of such insurance and they apply to a proportionate amount of the proceeds where both employer and employee pay part of the cost. See footnote 13, *supra*.

But 1954 Code Section 106 gives a corresponding benefit not available under the 1939 Code, for it excludes from the employee's taxable income any contributions made by the employer for such insurance and thereby gives a tax benefit to the employee to the extent that such contributions might otherwise have been includible in his income when made, *viz.*, as where the employer took out individual policies for individual employees.

employer during periods of illness. See also brief of the *amicus curiae*, pp. 13, 22.

As we show, pp. 29–39, *infra*, the analogy between insurance and wage continuations is a dubious one. We here emphasize that Congress, even in the liberalizing provisions of the 1954 Code, chose to distinguish between cash wage payments received by an employee, part of which he uses to pay for a health insurance premium, and equivalent benefits indirectly conferred by an employer. The total cash wages actually received are taxable as income to the employee in the year of receipt, while the health insurance proceeds which he receives and which are attributable to the premiums paid by him are exempt from tax. On the other hand, no matter how the employer makes provision for sick benefits, the employee has no taxable consequences until a period of illness and then only a limited exemption becomes operative. In other words, Congress has *not* adopted the theoretical approach which the taxpayers urge. (Cf. taxpayers' Br. 20–21.)

The 1954 Code shows, in brief, that Congress regarded a wage continuation plan as a direct payment of compensation for services rendered, or to be rendered, just as is true of paid vacations, year end bonuses, pensions,[15] death benefits, profit sharing plans, stock option

[15] Arguments similar to those advanced in this case have been made by taxpayers attempting to have retirement pensions, paid to them by their employers, taxed as "annuities" under Section 22 (b) (2) of the Internal Revenue Code of 1939. The courts have realistically recognized, however, that such benefits are received by the employees for services rendered and are not an-

plans and other kinds of benefits. For some of these so-called fringe benefits, Congress has made special provision in the tax laws, as it has now done for wage continuation plans during illness.[16] But, as is evident, Congress did not view the narrow exemption previously accorded "health insurance" in the 1939 Code as embracing such wage continuation plans.

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nuities in the statutory sense. See *Hooker* v. *Hoey*, 27 F. Supp. 489 (S. D. N. Y.), affirmed, 107 F. 2d 1016 (C. A. 2d); *Wolfe* v. *Commissioner*, 8 T. C. 689, affirmed, 170 F. 2d 73 (C. A. 9th), certiorari denied, 336 U. S. 914.

In *Menke* v. *Thompson*, 140 F. 2d 786, 791 (C. A. 8th), a pension plan voluntarily established by an employer was not thought to be a contract of insurance, although by applying the reasoning advanced by taxpayers in this case it might be labeled "old-age insurance." See also *Waller* v. *United States*, 180 F. 2d 194 (C. A. D. C.), where the court, refusing to give a labored interpretation to Section 22 (b) (5), held that amounts received under a federal statute as a result of retirement for physical disability were not in the nature of workmen's compensation.

[16] For a discussion of some of the tax problems and the legislative solution see: Bomar, *Requirements for Qualification of Plans (Compensation Problems: Pensions and Profit-Sharing)*, 13 N. Y. U. Institute on Federal Taxation (1955) 395; Block, *Deductibility of Employer Contributions to Qualified Pension and Profit-Sharing Plans*, *id.*, p. 409; Hodgkin, *Taxability of Benefit Payments under Qualified Pension and Profit-Sharing Plans*, *id.*, p. 429; Alexander, *Tax Status of Pension Trusts: Requirements for Maintaining Exemption*, *id.*, p. 435; Young, *Deferred Pay Plans—Qualified and Non-Qualified Plans*, *id.*, p. 457; Beck, *Family Benefits and Family Security: Employee Death Payments*, *id.*, p. 471; Lentz, *Stock Ownership Plans—Options, Warrants, Leverage Stock*, *id.*, p. 499; Gordon, *Health and Welfare Plans—Other Fringe Benefits*, *id.*, p. 521.

D. THE PAYMENTS RECEIVED BY THE TAXPAYER FROM HIS EMPLOYER WHILE ABSENT FROM WORK WERE TAXABLE WAGES; THEY WERE NOT TAX-EXEMPT PROCEEDS OF HEALTH INSURANCE

The taxpayer's argument is essentially this—the wage continuation plan has the essential characteristics of insurance in that the company, by a binding contractual obligation, has, for a consideration (paid by the employee in the form of services), agreed to indemnify (to an extent) its employees against loss of wages due to illness, and thereby the risks which the employees would otherwise bear have been shifted to the employer.

The word "insurance," however, is not a term which has a sharply defined, inflexible meaning which can be applied without regard to the context in which it is used or to the factual situation being tested. As the court said in *Jordan* v. *Group Health Ass'n,* 107 F. 2d 239, 245, fn. 13 (C. A. D. C.):

> Each word, "insurance" and "indemnity", is used in a great variety of situations and with meanings which vary according to that in hand. General definitions torn from the context of specific facts and legal issues do not help greatly, often merely confuse. Some are so all-covering as to embrace nearly the entire law of contract. Cf. (1937) 23 Corn. L. Q. 188, 193.

We have already examined (pp. 14–18, *supra*) the context in which Congress has used the term "health insurance." We now turn to an examination of the so-called plan of the employer which is involved in this case to demonstrate that, viewed in its entirety,

it could not properly be regarded as providing anything except compensation for services, and that it could not properly be classified as "compensation for * * * sickness" under "health insurance" as Congress used these terms in Section 22 (b) (5). Standing alone, no one aspect of the plan need be considered decisive; in its totality, the plan is clearly one for providing a form of compensation to the employees for their services to the company.[17]

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[17] The fact that a contract, such as a contract of employment, provides incidentally for an added benefit to the employee on the happening of a stated contingency does not make it a contract of insurance for regulatory purposes. Vance, *Insurance* (3d ed.), p. 88. On the contrary, such payments when made are merely additional compensation. In *Beck* v. *Penna. R. R. Co.*, 63 N. J. L. 232, a relief fund was maintained jointly by the railroad and its employees providing for the payment of benefits to contributing employees if they became disabled or sick. Holding that the relief fund by its terms released the railroad from any additional liability growing out of the personal injury to Beck, if he chose to accept the benefits of the fund, and that the relief fund was not a contract of insurance and did not violate the New Jersey insurance laws, the court said (pp. 241–242):

> "A contract of similar import with a railway company which had established what was called a railway insurance society was held by the Court of Queen's Bench to be a labor contract between employer and employe. *Clements* v. *L. & N. W. Railway Co.*, 2 Q. B. 482 (1894). The contract before us is *the contract of an employer with an employe respecting the compensation the latter shall receive for his labor*, and the manner in which it shall be accounted for and paid for his relief or the benefit of his beneficiaries. *The payment by the company of the expenses of management and of contributions, to make up deficiencies is in the nature of additional compensation for labor* to those of its employes who enter into this contractural relation with it." [Emphasis added.]

See also *Sherer* v. *Smith*, 85 Ohio App. 317, 320; *Colaizzi* v. *Pennsylvania R. R. Co.*, 208 N. Y. 275, 286–287; cf. *Bowers* v. *Lawyers Mortgage Co.*, 285 U. S. 182.

1. The extent to which an employee will receive payments under the plan is directly related to length of service. (R. 72.) An employee who has been in employment for less than two years is entitled to nothing. Employees with more than two years' service receive payments equivalent to a stated number of weeks' full pay and half pay on an ascending scale, dependent on the number of years of employment. The longer the employment, the longer the period and amount of full pay received during absence attributable to illness.

The plan, without question, has the effect of rewarding and hence encouraging long periods of service. This is a desirable objective in the employer-employee relationship with obvious benefits to both parties. It tends to reduce labor turnover and the resulting stability of employment obviously redounds to the employer's benefit. The advantages to the employee are equally obvious. But what the employer pays and what the employee receives necessarily represents a reward for past services and is designed to encourage future services. This is compensation for services (even though the employee is not at work during the period). See *Commissioner* v. *LoBue,* 351 U. S. 243, 247; *Robertson* v. *United States,* 343 U. S. 711, 715. It can scarcely be distinguished from a paid vacation. It cannot be equated with "compensation * * * for sickness", which is what is exempt under Section 22 (b) (5).

Conversely, the plan does not resemble insurance in that persons subject to identical risks are not neces-

sarily entitled to equal "benefits." Loss of wages due to illness is as much a risk for the employee who has been in employment for less than two years as it is for the employee with two years' service. Yet the former will receive nothing, while the latter will receive payments for a limited period, although he will receive less than an employee with a longer period of service. Yet, assuming that these employees receive identical wage payments while on the job, each has, under the taxpayer's theory, made the same premium contribution to the employer in the form of services rendered.

Another feature of the telephone company's treatment of its employees during periods in which they become ill is worthy of note. During the first seven days of illness, the employee is not entitled to benefits under the plan. (R. 72.) Apparently, however, the employee continues, in some circumstances, to receive his salary during this period. (R. 15, 25, 27–29, 50, 72–73.) There can be no doubt that such an employee is protected during the first seven days as fully as he would be under the plan. The consideration furnished by the employee (his services) is the same; the continuation of salary by the company is the same; and the risk feature is at least equally as great. Yet no contention is made that amounts received during this period of seven days are received through "health insurance", even though, if the employee enters his employment with the understanding that this is part of his compensation, his rights to these amounts would be enforceable as contract rights. The company does

not distinguish between payments for the first seven days and payments made under the plan (R. 25), and, indeed, the only possible distinction is that the plan has been set forth in writing for the employee while no written provision has been made for payments for the first seven days. And this formal difference, we submit, is not sufficient to convert what are immediately recognizable as sick leave payments, which are taxable, into health insurance payments which are non-taxable.

2. Insurance, as the term is normally understood, involves a payment of premiums by those who, sharing a common risk of loss, are enabled to shift it to another, thus providing a fund which can serve to idemnify those who actually suffer a loss. In the present situation the employees paid no premiums. Nor did the employer pay anything resembling premiums on insurance.

Taxpayer contends, as we have already noted, that each employee furnishes consideration by performing services and that this, in reality, is the equivalent of premium payments. (Br. 14–15.) Presumably, the taxpayer assumes that each employee, because of the existence of the plan, received less of a cash wage payment than he would have received if there had been no plan, and that this theoretical wage differential represents the premium payments just as though the employees had received larger wages and had made a direct expenditure for premium payments on insurance.

But there is not the slightest indication that Congress, in using the word "insurance", was legislating

in terms of "some esoteric concept derived from subtle and theoretic analysis." [18] *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 561. Any form of additional compensation, such as pensions, death benefits, etc., could be equated as an abstract matter to a wage differential which might otherwise be paid by the employer in the form of direct compensation. Yet, quite plainly, an employee is not regarded as paying "premiums" for these benefits.

In this connection, it is significant that under Section 22 (b) (5) of the 1939 Code, and even under the 1954 Code with its expanded tax benefits, Congress differentiated between the situation where the employee uses part of his regular wages for the payment of insurance premiums and the case in which he receives compensation from his employer during illness.

Thus, Section 22 (b) (5) of the 1939 Code was amended by Section 127 (d) of the Revenue Act of 1942, c. 619, 56 Stat. 798, to exclude from the exemption "amounts received for compensation for personal injuries or sickness which are attributable to and not in excess of deductions allowed under section 23 (x) in any prior taxable year." See S. Rep. No. 1631,

[18] Even from a theoretical viewpoint, the taxpayer's assumption will not withstand analysis. Thus, employees who perform identical services and receive identical wage payments, would be paying the identical, theoretical "premium" under the taxpayer's analysis and each, of course, is subject to the same risk of loss. Yet the employee who has less than two years of service is not "insured", and the employee with two years of service has much less "insurance" than the employee with 25 years of service. This, indeed, would be a strange kind of "premium" payment.

77th Cong., 2d sess., pp. 95–96 (1942–2 Cum. Bull. 504, 576–577). Section 23 (x) contemporaneously added to the Code [19] (26 U. S. C., 1952 ed., Sec. 23), provides for the deduction of extraordinary medical expenses. This section, too, referred to "accident or health insurance" and in this context there is no doubt that Congress was thinking in terms of commercial insurance, for which the insured was paying a cash premium.[20] Thus, the employee who receives a cash wage and uses a part of it to pay premiums on a health insurance policy would be taxed with the full amount of his salary and would be entitled to a deduction only to the extent that the premium payments and other medical expenses qualify for the limited deduction granted by Section 23 (x). But where, as here, the employee receives a cash wage and the employer maintains a wage continuation plan, there is not the faintest indication that Congress intended to tax the employee with a weekly wage rate in excess of that actually received while on the job, or that a theoretical wage differential should be considered as having been paid by him as premiums for "health insurance" which would qualify for deduction under Section 23 (x).

3. A further significant difference between the situation exemplified by this case and one where there is a

[19] Section 127 (a), Revenue Act of 1942, *supra*.

[20] There is no reason to suppose that Congress used the phrase "accident or health insurance" differently in Section 23 (x) than it did in Section 22 (b) (5), especially since Section 23 (x) is referred to specifically in Section 22 (b) (5). Cf. *United States* v. *Olympic Radio & Television*, 349 U. S. 232.

conventional insurance arrangement lies in the fact that no fund was created which could serve as a source for the payment of "insurance."

It need not be decided whether, in using the term insurance, Congress intended to limit the exclusion to payments made by companies which are regulated by the states as "insurance" companies.[21] It is enough to say that where no definable premiums are paid and no separate fund exists to assure the payment of claims, the situation is one which does not resemble insurance, as that term is ordinarily understood.[22]

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[21] The employer here was not licensed to engage in the insurance business. (R. 51.) In the *Epmeier* case, the company involved was an insurance company that engaged in the business of writing health insurance policies. 199 F. 2d 508, 509. It is not possible to state just what weight was given to that fact in *Epmeier*.

[22] The reliance of the *amicus curiae* (Br. 23–24) upon I. T. 4015, 1950–1 Cum. Bull. 23, is misplaced. The position of the Internal Revenue Service to the effect that voluntary employer sick leave plans were not health insurance was set forth in G. C. M. 23511, 1943 Cum. Bull. 86. The ruling in I. T. 4015 was apparently influenced by the fact that the plan met with requirements of the California Unemployment Insurance Act. In I. T. 4107, 1952–2 Cum. Bull. 73, the Service modified I. T. 4015 and stated plainly that compliance with insurance requirements of state law did not necessarily mean that a plan was health insurance within the purview of Section 22 (b) (5). See also Rev. Rul. 209, 1953–2 Cum. Bull. 104.

Where the employees make no direct contributions, or where no separate fund exists for the payment of benefits, or where the amount of benefits are related to length of employment, the Service has ruled that the exemption of Section 22 (b) (5) is not applicable. See Rev. Rul. 54–1, 1954–1 Cum. Bull. 29; Rev. Rul. 209, 1953–2 Cum. Bull. 104; I. T. 4107, 1952–2 Cum. Bull. 73. But where benefits are payable without regard to length of service, a separate fund is established for the payment of benefits, the employees make direct contributions to the fund, and the employer

The absence of any fund is particularly significant for, as we have seen (p. 23, *supra*), the congressional understanding was that Section 22 (b) (5) of the 1939 Code applied only where the "amounts are funded through insurance." H. Rep. No. 1337, *supra*, p. A33 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4169).

Still other relevant circumstances support the view that this case does not involve "insurance" in the accepted sense—the absence of any actuarial computation of the risks which might be incurred and the cost of assumption of those risks (R. 51); the fact that the employer treated expenses of the operation of the plan and the costs of benefits paid under the plan in the same manner as other expenses of doing business (R. 99); the fact that the company withheld income taxes on the payments made to taxpayer under the plan; the fact that payment to an employee for time actually worked and payment under the plan, if occurring in a single pay period, were made in the same check (R. 51);[23] the fact that the employee received no benefits during a period of lay-off even if he were ill in that period (R. 81); the fact that no benefits were paid if the employee was receiving wages from the company (R. 73); the fact that the plan

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administers the fund in accordance with provisions of state law, the benefits received from the fund by contributing employees have been held to qualify for exemption under Section 22 (b) (5). Rev. Rul. 208, 1953-2 Cum. Bull. 102.

[23] Normal pay roll deductions for insurance premiums, purchase of United States bonds and the like are made from amounts paid to employees under similar plans. See *Cary* v. *United States*, 141 F. Supp. 750, 756 (Nebr.), and *Townsend* v. *United States*, 143 F. Supp. 150, 152 (S. D. Ill.).

provided that the company, if it desired to do so, could pay greater amounts than provided for in the plan (R. 50); and the fact that the plan could be changed at the will of the employer (R. 88).[24] Instead, these circumstances point to the conclusion that the plan was intended to furnish additional compensation to employees in consideration of their services.

In the final analysis, this case involves nothing more than an agreement by the telephone company to continue paying its employees their salary if they become sick and are not able to come to work. As the Tax Court stated in *Oliva* v. *Commissioner*, 25 T. C. 1289, 1294:

> What the employer did, as we view the facts, is nothing more nor less than undertake to pay "sick leave pay" to petitioner or, to put it another way, to keep petitioner on the payroll during certain periods of illness when he was unable to work. There is a difference, to our way of thinking, between "health insurance" and the sick benefits payable under the Disability Benefit Plan, which, while hard to define, nevertheless exists. Sick pay is essentially tied into the employer-employee relationship. Such pay is earned by the employee as he works. He pays for it in no other way. No

[24] The *Epmeier* case stated that it was unimportant that the terms of the plan could be changed at will by the company since the employee could always terminate his employment. 199 F. 2d 508, 511. This reasoning, however, leads to the conclusion that this is not health insurance, but rather an element of compensation. It would indeed be strange for an employee to have to terminate his employment because the terms of a "health insurance" policy were not satisfactory to him.

premiums are collected from him and no insurance fund exists. Fundamentally the amounts paid to petitioner fall within the broad definition of "gross income" contained in section 22 (a) which includes "income derived from salaries, wages or compensation for personal service." They are compensatory in nature, paid to him because he was an employee and not because his employer insured him against sickness.

To treat sick leave payments as health insurance payments requires that the language of Section 22 (b) (5) be given an interpretation which does not conform to the general understanding of the words "health insurance". Congress, in liberalizing the law in the 1954 Code, has not gone so far as the taxpayers urge. Congress has recognized that a fringe benefit, such as sick leave, is compensatory in character and it has provided that only limited amounts of sick leave payments may be excluded. There is no basis for suggesting that such payments were exempt *in toto* even before Congress liberalized the law.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
HILBERT P. ZARKY,
MARVIN W. WEINSTEIN,
Attorneys.

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APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) [as amended by Sec. 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * *

(5) [as amended by Secs. 113 and 127 (d) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Compensation for injuries or sickness*).—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 23 (x) in any prior taxable year, amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus

the amount of any damages received whether by suit or agreement on account of such injuries or sickness, and amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country;

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

Internal Revenue Code of 1954:

SEC. 104. COMPENSATION FOR INJURIES OR SICKNESS.

(a) *In General.*—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness;

(3) amounts received through accident or health insurance for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer); and

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service.

(b) *Cross References.*—

(1) For exclusion from employee's gross income of employer contributions to accident and health plans, see section 106.

(2) For exclusion of part of disability retirement pay from the application of subsection (a) (4) of this section, see section 402 (h) of the Career Compensation Act of 1949 (37 U. S. C. 272 (h)).

(26 U. S. C. 1952 ed., Supp. II, Sec. 104.)

SEC. 105. AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS.

(a) *Amounts Attributable to Employer Contributions.*—Except as otherwise provided in this section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

(b) *Amounts Expended for Medical Care.*—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in section 213 (e)) of the taxpayer, his spouse, and his dependents (as defined in section 152).

(c) *Payments Unrelated to Absence From Work.*—Gross income does not include amounts referred to in subsection (a) to the extent such amounts—

(1) constitute payment for the permanent loss or loss of use of a member or function of the body, or the permanent disfigurement, of the taxpayer, his spouse, or a dependent (as defined in section 152), and

(2) are computed with reference to the nature of the injury without regard to the period the employee is absent from work.

(d) *Wage Continuation Plans.*—Gross income does not include amounts referred to in subsection (a) if such amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness; but this subsection shall not apply to the extent that such amounts exceed a weekly rate of $100. In the case of a period during which the employee is absent from work on account of sickness, the preceding sentence shall not apply to amounts attributable to the first 7 calendar days in such period unless the employee is hospitalized on account of sickness for at least one day during such period. If such amounts are not paid on the basis of a weekly pay period, the Secretary or his delegate shall by regulations prescribe the method of determining the weekly rate at which such amounts are paid.

(e) *Accident and Health Plans.*—For purposes of this section and section 104—

(1) amounts received under an accident or health plan for employees, and

(2) amounts received from a sickness and disability fund for employees maintained under the law of a State, a Territory, or the District of Columbia,

shall be treated as amounts received through accident or health insurance.

(f) *Rules for Application of Section 213.*—For purposes of section 213 (a) (relating to medical, dental, etc., expenses) amounts excluded from gross income under subsection (c) or (d) shall not be considered as compensation (by insurance or otherwise) for expenses paid for medical care.

(26 U. S. C. 1952 ed., Supp. II, Sec. 105.)

SEC. 106. CONTRIBUTIONS BY EMPLOYER TO ACCIDENT AND HEALTH PLANS.

Gross income does not include contributions by the employer to accident or health plans for compensation (through insurance or otherwise) to his employees for person injuries or sickness.

(26 U. S. C. 1952 ed., Supp. II, Sec. 106.)